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AUTHOR Deitch, Kenneth M.
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ABSTRACT

A National Education Loan Bank (NELB) is proposed as an alternative to existing federal loan programs for education, such as the National Direct Student Loan program and the Guaranteed Student Loan program. The history and structures of these two programs are detailed: financing, costs, insurance arrangements, agencies, volume, and interest rates. The proposed NELB has these features: (1) it is intended to greatly reduce the federal subsidy that keeps the other programs' interest rates low; (2) it would operate entirely on capital the government raises through borrowing; (3) it would transfer the task and paper work of loan origination from the bank to the financial aid officer, a substantial savings to the program; (4) it encourages and enables loans to parents as well as to students; and (5) it calls for collection to be managed by the Internal Revenue Service to minimize default. It is felt that with this program the cost per dollar loaned may drop 37.5 percent, some complexities would be eliminated, and the volume of loans would increase by $62.5 billion. Issues raised by this approach to educational loans--such as the principle of govenment subsidy and the reduced program flexibility--are discussed. (MSE)

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K.M.D.

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I. INTRODUCTION

The purpose of this paper is to discuss a National Educational Loan Bank (NELB) as an alternative to the existing federal loan programs for education of which the major ones are the National Direct Student Loan (NDSL) program and the Guaranteed Student Loan (GSL) program.

Right at the start it may be helpful to present, even without discussion, the gross numbers pertaining to the size of NDSL and GSL to convey some sense of the orders of magnitude involved. These numbers appear in Table 1. The next section of the paper will be devoted to placing them in context.

TABLE 1

NDSL and GSL Programs:
Major Data on Their Size,
Fiscal Year 1979

	NDSL	GSL
Budgeted Cost to the Federal Government (millions of dollars)	340*	970
Value of Loans Initiated (millions of dollars)	717.1	2,250
Number of Loans Initiated (thousands)	1,010	1,126
Average Size of Loans Initiated (dollars)	710	1,998
Estimated Principal Value of All Loans Outstanding, end of FY '79 (billions of dollars)	3.5	7.8

*Includes estimate of $10 million for costs of administration and $20 million for costs incurred for loan cancellation for teachers.

In any discussion of lending to help families pay the direct charges for education, two issues -- one largely philosophical and one largely practical -- need to be confronted at the outset.

First, is it a "good thing" to lend students not inconsequential sums for education, especially public education? There exists deep disagreement over the proper answer to that question. One view is that tuition should remain low, that an undergraduate program in the public sector should be, if not free, at least low-cost, and that the very existence of well-financed, smoothly-running loan programs undermines those ideals. Along with this view goes the notion that it is something of a mixed blessing to provide help in a form which, as a by-product, makes students into debtors. A quite different view is that higher education is a profitable investment for the individual and that to lend students public or publicly-guaranteed money with which to invest in themselves is, though not as generous as an outright grant, still very generous. Along with this view frequently goes the notion that higher educational institutions' prices should more nearly reflect costs than they do at present and that the ready availability of loans can facilitate progress towards that objective.

This philosophical conflict has a very practical consequence for proponents of an NELB. Presumably the purpose of the bank would be to improve the entire lending apparatus, but there are those who have no interest in "improving" that apparatus if the "improvement" implies a large, well-run, well-financed program of lending because such a program is seen as an important step in the direction of shifting the burden of paying for public education away from the public and towards the student. Those opposed to an NELB because they oppose such a shift may be expected to pursue their case vigorously because of their belief that, if the NELB is successful, the process that developed it would be irreversible. Once the bank works, goes the argument, there would be dwindling political support for state-level appropriations as well as for the grant component of financial aid at

both the state and federal levels. The argument is that the NELB goes hand in hand with transferring ever more of the cost of education to students.

The second issue -- the practical one -- concerns the underlying conditions of supply and demand in the market in which loans are provided and sought. There are exceptions, to be sure, but typically there is no way in which, without a third party participating to alter the underlying preferences of the buyers or sellers, there will be much volume in the market because there is no interest rate which will simultaneously bring the typical buyer and seller together. To be willing to make unsecured loans relatively routinely to students, the private lender might require an interest rate of, say, twenty-five percent. To seek a loan, the typical student would presumably be willing to borrow only at a much lower rate. Thus, without a third party to take action which somehow closes the gap between bids for, and offers of, loans, this market will have, at most, a very small volume of transactions.

The high rate of interest the lender requires is a reward for bearing risk, and lending to students without security is regarded as highly risky which means the lender believes the chance of not collecting is greater on such a loan than on plausible alternatives. This point serves to underline the critical element in any program of loans for education: the process of repayment. In a chronological flow chart of how a loan program operates, repayment comes last, but in planning such a program it is the most important item. Actually, repayment involves two separate elements, and each must be well planned. First, each borrower's schedule of repayments must be manageable in the context of his or her income. Second, procedures must aim to minimize the chance that the borrower will fail to honor the theoretically manageable obligation. In this regard the range of current experience is worth noting: the default rate on NDSL loans varies from in the neighborhood of two percent in some institutions to over ninety percent in others.

II. THE MAJOR CURRENT PROGRAMS*

How do the current programs work? What do they accomplish, and what do they cost? Table 1 presented an initial indication about the size of NDSL and GSL. Now it is time to provide additional details.

GSL and Sallie Mae

Under the GSL program institutions designated as lenders -- mostly banks and educational institutions -- lend money to students. All told, there are approximately 19,000 eligible lenders of which 18,800 are banks and other financial institutions and 200 are educational institutions. Of the latter, 170 are in the collegiate sector, and 30 are not. Although the number of institutions formally eligible to lend is large, the number actually lending at any one time is much smaller. Today, about 900 banks and about 100 colleges and universities actively lend.

The federal government does not make any loans under this program. Instead its role is to keep the cost of borrowing low to the students while simultaneously doing two things for the lenders: eliminating their risk of loss by guaranteeing repayment and insuring that their return will be sufficiently high to motivate them to provide a flow of capital. The guarantee which the federal government provides lenders against the loss of capital through the borrower's death, disability, default, or bankruptcy takes two forms. In the one the guarantee is provided to the lender directly -- in the Federal Insured Student Loan (FISL) program. In the other, the federal government reinsures the insurance provided by another agency -- typically

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*This section has benefited because I have had access to the excellent statement of Alfred B. Fitt, General Counsel, Congressional Budget Office, presented on May 30, 1979, before the Subcommittee on Postsecondary Education, Committee on Education and Labor, U.S. House of Representatives.

public -- which exists in some states. States having such agencies are referred to as guarantee agency states, but loans provided by an educational institution are always insured through the FISL program even if that institution is located in a guarantee agency state.

What are the main categories of cost the federal government incurs in its overall insurance and reinsurance program collectively referred to as the GSL program?

First, there are the administrative costs of running the federal apparatus associated with the program. In addition, as a result of the Education Amendments of 1976, the federal government now pays most of the administrative costs of the various guarantee agencies. By the end of fiscal year 1979, forty-one states are scheduled to have such agencies.

Second, as already indicated, the federal government reimburses the lender whenever a borrower fails to honor an obligation. If the loan was insured under the FISL program, the federal government pays the institution directly. If the insurance was provided through a guarantee agency, the federal government reimburses that agency upon learning that it has discharged its direct obligation to the lending institution.

Third, the federal government makes interest payments. The payment goes to the lending institution either directly or via the guarantee agency, depending on which program covers the case at hand. Payments are of two types. First, there are the so-called in-school interest subsidies. Once a loan enters repayment, the borrower is charged interest at 7 percent, but while the borrower is enrolled, the federal government pays that obligation. Prior to 1 November 1978, the federal government undertook this obligation in all cases in which the family income was below $25,000 but only rarely in other cases. However, the Middle Income Student Assistance Act (MISAA) made all GSL recipients eligible for the in-school subsidy, no matter how large the family's income.

The second type of interest payment is the special allowance. In 1965, the interest rate on guaranteed loans was established at 6 percent; in 1969 it was increased to 7 percent as an incentive to attract private capital. But even 7 percent was regarded as too low a rate for the lenders to receive, although more than 7 percent was regarded as too much to ask students to pay. This dilemma -- that the lenders should receive more, but that the students should not pay more, than 7 percent -- was resolved by Congress' permitting the payment of a "special allowance," supplementary interest paid directly by the federal government to the lenders. The minute technicalities apart, the special allowance is now 3.5 points below the Treasury bill rate and, additionally, constrained by a maximum value, originally 3 percent but raised to 5 percent as of September, 1977.

In the context of the current high level of interest rates and the presumed stimulation of demand for GSLs created by making students from families in the upper regions of the income distribution eligible for the in-school subsidy, an additional comment about the maximum value of the special allowance is in order. As the legislation is written, the maximum pertains to the average over four consecutive quarters rather than to the value in any particular quarter, and during the two quarters from 1 January through 30 June of 1979, the annual rate has actually been above 5 percent -- at 5-5/8 percent and 6-1/4 percent, respectively. The arithmetic is such that, for the quarter beginning on 1 July 1979, the maximum constraint becomes binding. No matter how high the rate goes on Treasury bills, the special allowance cannot exceed an annual rate of 4 percent for that quarter unless the legislation is changed. The point is important because, if the legislation is not altered, the decline in the special allowance will probably roughly coincide with a spurt in demand occasioned by the relevant provision in MISAA.

Table 2 provides some sense of the magnitudes of the major items of cost to the federal government arising from the GSL. Good data on administrative costs are not available, and no estimates are provided. Defaults have attracted most of the publicity, and, to be sure, the cost of compensating the lenders for them is large, but it is not nearly so large as the costs incurred by paying interest while students are enrolled and by paying the special allowance on all loans. A major cause in the increase in the overall cost of the special allowance has been the increase in the rate at which it is computed. As recently as the first half of 1977, that rate was in the range of 1¼ to 1½ percent whereas during the first half of 1979 it has been in the neighborhood of 6 percent.

Table 3 provides several measures of the size of the GSL, both the volume of lending as well as the cumulative value of loans outstanding. In recent years, between 900 thousand and just over 1 million insured loans have been issued annually; their average size grew by nearly 40 percent between fiscal year 1975 and fiscal year 1978. In that same period the total value of new annual lending grew from $1.2 billion to $1.9 billion.

Exactly how much GSL borrowing there will be in the coming period is hard to forecast with confidence, but there is reason to believe that it will expand substantially, especially in response to MISAA which, in this era of rapid inflation, has provided an opportunity to borrow money and pay literally zero interest while the student is enrolled. It seems especially likely that families in the upper regions of the income distribution will take advantage of this opportunity. Factors pointing towards such an outcome are first, the growing sense that the GSL is a loan of convenience through which the student's borrowing capacity can help finance the expected parental contribution (EPC) and second, the fact that a large share of all

TABLE 2

Elements of Cost to the Federal Government,
Guaranteed Student Lending,
Insurance and Reinsurance Programs
(millions of dollars)

	FY1975	FY1976 (annual rate)*	FY1977	FY1978	FY1979 (est.)	FY1980 (est.)
(1) In-School Interest Subsidy	210	202	225	249	314	358
(2) Special Allowance	127	78	106	195	390	378
(3) Net Defaults**	110	148	151	182	187***	166***
(4) Bankruptcy	-	-	10.6	9.3	10.6	11.9
(5) Death & Disability	3.6	3.6	4.9	5.6	6.0	6.7
(6) Total of Items Listed (rounded)	451	432	498	641	908	921

*Figures provided for the 15-month FY have been converted to an annual rate.

**Once a default claim has been paid, the government attempts to collect from the student. The net figure provided subtracts any collections from the payments.

***$10.0 million and $10.5 million are included, respectively, in the estimates for FY 1979 and FY 1980. These sums are to be transferred to the general Salaries and Expenses budget for personnel involved in efforts to collect default loans.

TABLE 3

Annual Volume of Lending and
Cumulative Value of Loans Outstanding,
Insurance and Reinsurance Programs

		FY1975	FY1976 (annual rate)*	FY1977	FY1978
(1)	Number of Loans Made (in thousands)	919	966	941	1,025
(2)	Average Size of Loans Made (in dollars)	1,314	1,436	1,562	1,809
(3)	Total Value of Loans Made (billions of dollars)	1.2	1.4	1.5	1.9
(4)	Cumulative Value of Outstanding Loans (billions of dollars)	5.3	5.7	6.2	6.8
(5)	of (4) In Repayment	2.1	2.4	2.7	2.8
(6)	of (4) Not In Repayment	3.2	3.3	3.5	4.0

*Figures provided for the 15-month FY have been converted to an annual rate.

parental contributions are estimated to come from those families with incomes over $25,000.

Lines 4, 5, and 6 in Table 3 indicate the value of loans outstanding. Line 5 is especially interesting because it provides a measure of the federal government's potential short-term liability. Despite the problems of default, it is still far-fetched in the extreme to imagine that every student currently repaying a guaranteed loan would suddenly default. However, if, for the sake of argument, such a thing had happened during fiscal year 1978, the federal government's cost would immediately have increased by roughly $2.8 billion.

Perhaps the most important point which this rather extreme example suggests is that the cost of the guaranteed loan program is, for practical purposes, out of the government's hands, at least in the short run. If the default rate suddenly increases, so, too, will the government's cost. If the general level of interest rates rises, so, too, will the government's cost. Indeed, with nearly $7 billion of guaranteed loans outstanding in fiscal year 1978, a one-point increase in the special allowance would cost the government roughly $70 million annually.

In any study of the GSL program, there is one other element to describe. It is formally separate from GSL, but there is an important interaction. That element is the Student Loan Marketing Association, more informally known as Sallie Mae.

Sallie Mae was created by Congress in the Education Amendments of 1972. It is a private, profit-making corporation, and its purpose is to provide a secondary market for loans to students which have been guaranteed by the federal government. Sallie Mae's central <u>modus operandi</u> is twofold. First, it has what is known as a "warehousing" operation in which it lends money

to banks which use their student notes as collateral in the ratio of $1.25 of collateral for every $1 of credit. When a bank borrows from Sallie Mae in this way, it must use the proceeds to increase its lending to students. Second, Sallie Mae buys student loans from banks -- ordinarily at par -- in which case it obtains all the privileges and obligations of ownership. In particular, it receives the special allowance on the loans which it owns, and it must also arrange to collect those loans. Once the loan has been purchased by Sallie Mae, the student deals directly with one of Sallie Mae's five servicing agents. If the loan is defaulted, the servicing agent files the appropriate claim with the regional office of the Office of Education.

In lending to banks and in purchasing student loans from them, Sallie Mae spends. But where does it obtain its funds? As a corporation it has stockholders from whom it received, net, $23.9 million when it issued stock in the second quarter of 1974. Moreover, other than a $250,000 dividend paid in 1977, the corporation has retained all net earnings. The amounts are indicated in Table 4.

TABLE 4*

Sallie Mae's Net Income
(millions of dollars,
years ending 31 December)

1973	.1
1974	.3
1975	1.8
1976	2.2
1977	4.3
1978	5.9
First quarter of 1979	1.9

*The data in Tables 4-9 on Sallie Mae come from that corporation's reports. The data for 1973 through 1978 come from annual reports. The data for the first quarter of 1979 come from the report for that period.

But stockholders' equity and retained earnings have been only a small part of Sallie Mae's total source of funds. The main source has been borrowing. Even though it is a private corporation, Sallie Mae has been given what amounts to public-agency privileges and status in the credit markets for ten years. In particular, its obligations are guaranteed by the Secretary of Health, Education, and Welfare, and, as a result, it is allowed to borrow from the Federal Financing Bank (FFB) which it has consistently done since that institution came into existence in May, 1974. In principle Sallie Mae is to pay the FFB rates that are slightly above those on new U.S. government issues of comparable maturity, and in practice it is currently paying 1/8 percent above the rate on such issues. Table 5 indicates the magnitude of Sallie Mae's borrowing from the FFB by presenting the value of its outstanding notes as of 31 December in each of the years 1974 through 1978.

TABLE 5

Sallie Mae's Notes Payable

Year (as of 31 December)	Notes Payable (millions of dollars)
1974	220
1975	310
1976	410
1977	515
1978	915

To put them in perspective, Sallie Mae's liabilities through borrowing should be compared with its assets from its purchase of student loans and lending to banks. Table 6 presents these data. Together with the numbers in Table 5, they show that, on its central operations, Sallie Mae has

established itself as a financial intermediary, borrowing in one market and lending in two others. As of 31 December 1978, it owed the FFB $915 million and was owed, by the various students and banks, whose promises to pay it held, $857 million.

TABLE 6

Sallie Mae's Principal Earning Assets:
Student Loans Owned and Warehousing Loans Outstanding
(millions of dollars)

		Student Loans Owned	Warehousing Loans Outstanding	Total Principal Earning Assets
as of 31 December	1974	4	192	196
	1975	71	236	307
	1976	197	214	411
	1977	275	242	517
	1978	443	414	857

The fact that Sallie Mae operates as both a borrower and a lender prompts a comparison of its relative costs and gains in these two roles. Tables 7 and 8 illustrate the point. Table 7 shows the difference between the interest Sallie Mae spends to borrow in the one market and the interest it earns by lending in the two others, and Table 8 shows its aggregate borrowing and lending rates and the spread between them. In 1974 the spread in rates was unfavorable to Sallie Mae, but for all other years its average lending rate has exceeded its average borrowing rate. And even in 1974, Sallie Mae actually earned more in interest than it spent.

A final point of information about Sallie Mae concerns its aggregate size in comparison with the size of GSL. In recent years, it will be recalled, there have been in the neighborhood of 900,000 to 1 million GSL loans annually. The volume of lending in fiscal year 1978 was $1.9 billion,

TABLE 7

Sallie Mae: Interest Earned and Interest Paid
(millions of dollars)

	Interest Earned	Interest Paid	Net Interest Income
1974	20.6	18.4	2.2
1975	23.2	17.5	5.7
1976	30.0	23.1	6.9
1977	37.3	26.4	10.9
1978	64.7	49.6	15.1

TABLE 8

Sallie Mae: Average Rates
at Which it Borrowed and Loaned
(percent)

	Average Borrowing Rate	Average Lending Rate	Spread*
1974	8.99	8.48	(.51)
1975	6.92	8.31	1.39
1976	6.27	7.59	1.32
1977	5.38	7.59	2.21
1978	7.01	9.13	2.12

* ( ) indicates borrowing rate exceeds lending rate

and the cumulative value of all outstanding guaranteed loans was $6.8 billion. The data in Table 9, which largely repeat those in Table 6 from this new perspective, should be viewed in this setting. They indicate that Sallie Mae has grown rapidly and that, as of the end of 1978, the value of the capital that it has made available to the retail lending arena by buying loans and lending was about 12.6 percent as large as the value of all guaranteed loans outstanding. Whether one views this number as

encouragingly large, given Sallie Mae's youth, or distressingly small, given the tasks to accomplish and the relatively tranquil commercial environment in which Sallie Mae operates, is a matter over which reasonable people will, no doubt, differ.

TABLE 9

Indexes of Capital Sallie Mae Has Injected Into the Lending Process

		(2) Number of GSLs Owned by Sallie Mae	(3) Value of GSLs Owned by Sallie Mae (millions of dollars)	(4) Value of Loans Made Under Warehousing Program (millions of dollars)	(5) Capital Injected by Investing and Lending (3) & (4)
as of 31 December	1974	3,191	4.0	192	196
	1975	44,051	71.0	236	307
	1976	115,340	197	214	411
	1977	142,683	275	242	517
	1978	240,300	443	414	857
as of 31 March	1979	---	460	529	989

To summarize regarding GSL and Sallie Mae: recently, but before the full impact of MISAA has had time to take effect, the GSL's rate of annual lending has been about $2 billion annually, and its major annual items of cost have been about $900 million. In any simultaneous analysis of these two numbers, the crucial caveat is that the costs depend very largely on past rather than current lending. The two major elements of cost are for interest: the in-school subsidy and the special allowance. The cost of the in-school subsidy depends on the number and average size of loans in recent years. The special allowance, on the other hand, has a major

component of its cost depending upon the general level of interest rates. In one scenario -- admittedly extreme from the perspective of mid-1979 -- if the Treasury bill rate were to return to 3.5 percent, the cost of the special allowance would be zero, and the full brunt of paying the interest in the repayment period would return, once more, to the individuals who had done the borrowing.

With Sallie Mae, Congress has created a corporation to develop a secondary market for student loans and, in that sense, to increase the lenders' liquidity. In the environment in which it has been operating, Sallie Mae, by being allowed to borrow on terms just slightly less favorable than those available to the U.S. government itself, has been essentially insulated from the usual risks of commercial enterprise. Under these circumstances, the argument for having it be a profit-making enterprise is at least debatable.

With that controversial point set aside, there is no question that a secondary market has developed, but there is some disagreement about whether it is big enough to have truly accomplished the intended goals regarding the availability of credit to students. Sallie Mae's advocates tend to argue that the organization is expanding prudently, just the way a well-run commercial venture should. Its critics look at its volume of activity, perhaps especially at the fact that it has had dealings with only perhaps 400 of the 900 active GSL lenders, and wonder whether, given the nation's goals regarding the availability of credit, alternative arrangements might not be preferable. In this unresolved argument, one speculation on Sallie Mae's behalf is the notion that even when banks do not actually utilize the secondary market, they may lend to students more freely than they otherwise would merely because they know that Sallie Mae is there, available, if

needed. To repeat, this point is speculative, and the evidence to sustain or refute it is not readily available.

NDSL

The other major program of lending to review before discussing the proposal for an educational loan bank is the NDSL. The current program so designated -- the National Direct Student Loan program -- is a direct descendant of another NDSL, the National Defense Student Loan program of 1958 which took its final form as a compromise between the more liberal instincts of the Senate and the more conservative ones of the House. The outcome was a loan program with no interest while the student was in school and during certain authorized periods of grace thereafter. Once the loan entered repayment, the interest was at 3 percent. That rate has never changed, and today it is obviously a highly subsidized rate, but it is important to remember that, in the late 1950s, it was very near the federal government's cost of capital. For example, in March, 1958, the government was paying 2.98 percent on ten-year obligations.

To keep account of the politics regarding NDSL, it is important to be aware that recent administrations, on the one hand, and Congresses, on the other, have approached this program very differently. The administrations have made efforts to eliminate it, but at appropriation time, Congress has always restored NDSL's funding.

Table 10 shows the number and average size of loans since 1959-60. The number of loans made has been of the same order of magnitude in NDSL and GSL, but in recent years the size of the average loan under NDSL has been much smaller than under GSL.

In connection with NDSL, each participating institution -- 3,110 in 1977-78 -- maintains a fund into which three streams of money routinely

TABLE 10

Number and Average Size of NDSLs,
1959-60 Through 1979-80

Academic Year	Number of Loans (thousands)	Average Size (dollars)
1959-60	25	383
1960-61	115	434
1961-62	151	470
1962-63	186	478
1963-64	217	478
1964-65	247	484
1965-66	320	555
1966-67	378	568
1967-68	395	561
1968-69	429	521
1969-70	456	540
1970-71	452	532
1971-72	547	570
1972-73	646	616
1973-74	635	635
1974-75	690	650
1975-76	799	690
1976-77	834	690
1977-78	795	773
1978-79 estimates	1,010	710
1979-80 estimates	926	710

flow. First, there is Congress' annual appropriation referred to as the Federal Capital Contribution (FCC). Second, there is an annual contribution from the institution's own resources amounting routinely to one-ninth of the FCC. Finally, there are payments from the institution's former students who are repaying their NDSL loans. When the NDSL was first established, the loftiest ambition was that the program would eventually become self-sustaining without further FCCs, but that phase has not yet been reached.

The money in the fund is available to finance new lending. The allocation is done by the financial aid officer on the basis of measured need, and the loan ordinarily forms a portion of a package of financial aid having three components: loan, grant, and work-study.

Table 11 presents some data pertaining to the aggregate flows into the various institutions' funds. Unfortunately, an entire series for annual repayments is not readily available, though it is known that they were $314 million in 1977-78. The series in column (5) suggests that lending has been in the range of $600-700 million in recent years and serves as a reminder that the annual appropriation for the FCC is not a measure of the volume of lending. A corollary is that the stream of repayments would allow a continuation of NDSL lending at perhaps forty to fifty percent of the recent volume for a number of years into the future even if the FCCs were abruptly discontinued. Looked at somewhat differently, the numbers in Table 11 underline the close connection between the default rate and the cost of the program. In the GSL the government must compensate the aggrieved lender directly. In the NDSL, the analogue is simply that if other things are to remain equal, default must be compensated by an enlarged FCC or an enlarged institutional contribution which means, for most practical purposes, an enlarged FCC.

TABLE 11

NDSL: FCC, Estimated Institutional Contribution to Fund, Estimated Volume of Lending, 1959-60 Through 1979-80
(millions of dollars)

(1)	(2)	(3)	(4)*	(5)
Academic Year	FCC	Estimated Institutional Contribution to Fund	Total (2) & (3)	Estimated Volume of Lending
1959-60	31.0	3.4	34.4	9.6
1960-61	40.0	4.4	44.4	49.9
1961-62	58.4	6.5	64.9	71.0
1962-63	75.2	8.4	83.6	88.9
1963-64	91.4	10.2	101.6	103.7
1964-65	122.3	13.6	135.9	119.5
1965-66	146.7	16.3	163.0	177.6
1966-67	181.2	20.1	201.3	214.7
1967-68	192.0	21.3	213.3	221.6
1968-69	193.4	21.5	214.9	223.5
1969-70	193.4	21.5	214.9	246.2
1970-71	195.5	21.7	217.2	240.4
1971-72	243.0	27.0	270.0	311.8
1972-73	316.6	35.2	351.8	397.9
1973-74	292.3	32.5	324.8	403.2
1974-75	298.0	33.1	331.1	448.5
1975-76	329.4	36.6	366.0	551.3
1976-77	332.0	36.9	368.9	575.5
1977-78	310.5	34.5	345.0	614.6
1978-79	310.5	34.5	345.0	717.1
1979-80	310.5	34.5	345.0	657.5

*(4) is the annual addition to the fund except for repayments.

One important bit of information to convey about NDSL concerns the value of outstanding loans. As of 1977-78, the details were estimated to be the following:

Total principal outstanding:	$3.4 billion
in repayment:	$1.9 billion
not in repayment:	$1.5 billion

A final question to raise about NDSL is: who owns the student loan fund residing at each of the various institutions? The legislation stops short of saying outright that the money in the fund belongs to the U.S. government and the institution in the same proportions as their respective contributions, but it makes this statement by strong implication -- perhaps virtually by definition -- in specifying that, when the legislation establishing the fund expires, the money remaining as well as any future contributions from repayments should be distributed to the government and the institution in precisely those proportions.

This point is significant in planning for an NELB because it suggests an asset -- the stream of NDSL collectibles -- that could be turned over relatively costlessly to the NELB to provide it in its early years with an injection of capital. But such a development is not problem-free because, despite the fact that the legal record is quite clear about the ownership of the stream of repayments once NDSL is terminated, there are bound to be some hard feelings among institutions which have administered a fund for twenty years and which feel that somehow "the money is ours."

What difference does it make to an institution whether, as part of the transition to the NELB, roughly ninety percent of the money in its NDSL fund is assigned to this new bank? After all, the resources of that fund can only be used to make new loans. There are two situations in which the

institution would not be indifferent to such a loss. One would be if, by retaining its NDSL collectibles, it could have some money to lend at rates below those charged by the NELB. The other, and more significant one, would be if NELB funds available for lending to the institution's students were rationed. In that case an institution which had lost a substantial stream of NDSL repayments as a source of new lending would realistically miss it.

To summarize regarding NDSL: three streams -- a federal appropriation, the institution's contribution, and repayments from the institution's former students -- merge to provide funds for lending which each participating institution's FAO allocates on the basis of need as part of a package of financial aid. In recent years, the annual appropriation for the FCCs has been in the neighborhood of $300 million, and the annual volume of lending has been about $600-700 million with loans of around $700, on the average, going to about 800 thousand students per year. The default rate is a critical link between the volume of FCCs and the volume of lending. The volume of annual repayments is substantial, but the program has not yet achieved genuine "revolving fund" status. If the FCCs were suddenly to cease, lending could still go on for many years, but at a substantially reduced annual volume. The legal record is quite clear that if NDSL terminates, the government should receive as a refund the same proportion of each NDSL student loan fund's remaining assets as it contributed in the first place. In the aggregate this stream would be a good asset for the NELB, but some institutions may object strenuously to relinquishing it. The problem will be trivial if NELB funds are not rationed, more serious if they are.

III. A PROPOSAL FOR THE NELB

This section develops a plan for the NELB. Inevitably the operation of such a bank involves a very fine level of detail. What follows is not intended to cover every minute detail, but it is supposed to provide a clear sense of the bank's underlying principles as well as at least an order-of-magnitude comparison of the cost to the public from adoption of this plan as opposed to a continuation of the status quo.

Major Tasks a Program of Lending Must Accomplish

A good starting point is to list the major tasks which any program of lending must accomplish. Since all of the tasks must be accomplished, the program's success depends upon each, but, as mentioned earlier, in an important sense the last task chronologically is the most important. It is the "payoff," the "bottom line" -- choose what word you will. It is the task which, if not well handled, can truly undermine public confidence in, and support for, a program that utilizes public money. And that task is collection.

Beyond collection, there are five other major tasks. The second one is to provide the capital, and the third is to assume the risk. In ordinary commercial ventures, providing capital and assuming risk are united, both conceptually and in practice, but that union sometimes does and sometimes does not hold in lending for education. The fourth task is to provide the subsidy, if there is to be any. Fifth, there is the task of rationing the capital, should some mechanism for allocating it, other than the ordinary forces of supply and demand, be required. Finally, there is the relatively mechanical work of originating loans, of distributing the capital to the borrowers.

A second helpful introductory point is to note what kinds of simultaneous equilibria should, ideally, be established once the bank has entered a mature phase of operation in order for the system of lending to be stable and sustainable. There are two. First, in the aggregate, the supply of and demand for loanable funds should be in balance. This equilibrium must be established in the context of the size of the population of borrowers and the level of direct charges for education. The second criterion regarding equilibrium occurs at the microcosmic level: each student's level of debt should be consistent with a manageable repayment schedule.

Major Characteristics of the NELB

A broad summary of the central thrust of the NELB will serve as an introduction to a more thorough discussion of some of the essential points.

The most significant feature of the proposed bank is to eliminate, or at least dramatically reduce, the subsidy that currently keeps the borrowers' cost for interest substantially below the cost of borrowing to the government. In both the GSL and the NDSL, what is called a loan is actually a well-disguised mixture of grant and "true" or at least "quasi-true" loan. One major objective is to disentangle these components so that they can be recognized and distributed separately. The Congress should not feel reluctant to provide grants if it is inclined to do so, but it should provide them directly, not in a disguised form. If other things remain constant, this change will dramatically lower the government's cost of lending for education.

The next most significant feature is to operate the program fully on capital which the government raises through borrowing. The NELB should have the same access to the FFB as Sallie Mae now enjoys. The funnel that

now runs, for at least a portion of the capital that ends up as student loans, from the FFB, through Sallie Mae, and to some commercial lenders only succeeds in driving up the interest rate that must be charged to cover the costs of the institution originating the loan. If the borrower could be brought closer to the original, public source of capital, the price that needs to be charged for the loan could be reduced. And a similar argument applies even when the capital which the banks make available comes from sources other than Sallie Mae. The interest rate which will cover costs, including profit, for a bank is routinely higher than the rate that will make ends meet for the FFB.

Of course, whatever the source of the capital they disburse to students, a service the commercial lenders do provide is to originate loans. If lenders are by-passed, they would no longer provide this service. However, there is reason to believe that it would be easy -- actually cost-saving -- to compensate for this loss. After all, even when a bank is the originator of a guaranteed loan, the financial aid officer (FAO) still contributes some paperwork to the process. What is relevant is that, in the context of its environment, the bank's cost in doing the paperwork on a GSL is substantial whereas in the context of its environment, the financial aid office's cost of undertaking the paperwork now done by the bank would be trivial. Thus, to reallocate the task and associated paperwork of loan origination from the bank to the FAO -- a third significant feature of the proposed NELB -- can hardly fail to generate savings which can be passed along in the form of a reduced "cost-covering" level of interest.

The fact that, as a result of MISAA, the cost of paperwork associated with GSL in the aggregate will rise -- and it will rise in the financial aid office as well as in the bank -- should not be allowed to obscure the force of this latter point. Opportunities to economize by transferring paperwork from the bank to the financial aid office really do exist even though there will be a once-and-for-all increase in cost -- possibly a large one -- associated with absorbing MISAA into the system.

A fourth significant feature of the NELB is both to enable and encourage it to lend to parents as well as students. The omission of an option for parents to borrow is a major shortcoming of the current system. If one takes seriously the underlying assumption of need-based aid that parents should contribute as much as possible to the cost of their children's education, then the absence of a mechanism for lending to parents is a major missing link in any effort to have the system run properly.

The fifth introductory point to emphasize is that the proposal incorporates a process of collection that is designed to minimize default. Collection is to be managed by the Internal Revenue Service (IRS). There are, to be sure, objections that will be raised to such an arrangement. One of the more forceful is that once the principle is established of having the IRS become a debt collector, other agencies will also want to engage it for this purpose. A case can be made for drawing the line at loans for education, however, because they constitute the only type of debt for which collateral cannot readily be pledged. Therefore, for education loans above all others, the planning for collection must be as thorough and systematic as possible at the outset. A major part of the

task is simply to communicate to the borrowers that the process of repayment is a serious obligation although they should also know that generous provisions exist for postponement of payment in the event of "low" income, even for forgiveness if the borrower's "low" income becomes a permanent condition. But the generosity in cases of misfortune should in no way dilute the message that, in the ordinary course of events, the obligation to repay is serious. No better way exists to communicate this point -- a point which, once communicated, should be tantamount to minimizing default -- than to designate IRS as the agency charged with collection.

With those major points emphasized, a more detailed discussion of some of them, as well as of additional dimensions of the proposal for an NELB, follows.

Should the Loan be Subsidized?

The principle that the borrowers should be charged a rate of interest that approximates the cost of capital to the government requires additional comment. Relative to the current situation, this rate would be more than the borrowers are now paying but less than the principle originators of GSLs are now receiving. The broad strategy is to streamline the program by eliminating the middlemen. The borrowers should be expected to pay approximately the cost to that institution which can raise capital most economically, the U.S. government. Put another way, the nation should allow those borrowing for education to get their loans wholesale.

What this proposed principle means is that, as "subsidy" is usually defined, the educational loans made by NELB are to be all but unsubsidized, subsidized only to a very minor extent. The public at large will still pay three categories of cost: the cost of operating the bank, the cost of default -- which should be small if the proposal regarding collection is

adopted -- and the cost of forgiveness for those who, because of low incomes, qualify for deferment or cancellation of some portion of their obligation. Apart from these exceptions, each borrower is expected to pay roughly the same rate of interest as the government pays to borrow money for a comparable period of time.

Another perspective on the proposed arrangement is to note that, as the term financial aid is routinely used, the loans envisioned in the proposal are, in an important sense, not really financial aid. They are similar, but there is also enough of a difference so that, although it is subtle, it should nonetheless be noticed.

Although the proposed loans are essentially unsubsidized in the conventional meaning of the word, there is another sense in which they are very heavily subsidized indeed. The usual test of whether a loan is subsidized is whether the borrower pays the full cost of providing it. In the setting of educational loans, however, the government provides a second kind of subsidy by offering to guarantee repayment. The government, in effect, cosigns each loan. Anyone in doubt about the value of the government's guarantee should ask a few lending officers at commercial banks how, in the guarantee's absence, they would respond to the average eighteen-year-old who requested a loan for college, earnestly promising to repay out of future earnings. The point is that the guarantee is already a very valuable subsidy to the borrower, and it is also one which the government can provide virtually cost-free, if its loan program is well run.

In pursuing this question of the proper interest rate for the borrowers to pay, some history is helpful. Table 12 shows the relationship

between the rates of interest Congress has from time to time established for loans to students and the government's cost of long-term capital around the time when those rates were legislated. In 1958, the government was paying a bit more on its bonds than the 3 percent it set as the rate during repayment on NDSLs. In both 1965 and 1969, Congress established rates for students that were actually above its current cost of long-term borrowing. The relationship prevailing around the time the rates were legislated has tended to change because while the government's cost of capital has had an upward drift since the late 1950s, with the exception of the one change in GSL's rate from 6 to 7 percent, the interest rate faced by former students in repayment has not varied one iota once Congress has legislated it. As of 1979, the borrowers in repayment are paying much less than the government's cost of capital.

TABLE 12

Cost of Borrowing to the U.S. Government Compared to Interest Rates Established for Repayment Under NDSL and GSL (annual percent)

Year	Government's Cost to Borrow		Rate Legislated For Former Students in Repayment
	3-month Treasury Bills	Bonds	
1958	1.84	3.43	3 (on NDSL, never subsequently changed)
1965	3.95	4.21	6 (on GSL, in force until 1969)
1969	6.68	6.10	7 (on GSL, never subsequently changed)
March, 1979	9.48	9.12*	

* applicable to maturities of ten years only

The proposal being offered is to establish the principle that the interest rate on loans for education should approximate the government's cost of capital on obligations of comparable duration. The in-school subsidy apart, Congress' action in 1958 was consistent with that principle; its actions in 1965 and in 1969 actually went further. The amount by which the rates established in each of those two years exceeded the government's cost of capital can be viewed as the price of the in-school subsidy.

Merely to legislate rates for the repayment period based upon the suggested principle is not enough because rates so legislated have a way of remaining fixed. What is needed, therefore, is a mechanism to preserve the intended equality, to stabilize the rate to the borrowers in relation to the government's cost of capital. When the level of interest is pinned down in some unchanging rate -- 3 percent or 7 percent -- while, all around, significant variables are changing, the sacrifice a borrower makes in repaying a loan depends upon when the loan was obtained. A 3 percent interest rate in the late 1950s, or a 7 percent rate in the late 1960s, represented a much greater sacrifice than the same rates do in 1979. Why it makes sense to charge those borrowing in 1979 so much less is not clear. But even if the intention is to do more for them, the far preferable strategy is by varying the amount of aid that is available in the form of grants, not by varying the amount of grants hidden in what is referred to as the volume of lending.

Some calculations which D. Bruce Johnstone made not long ago provide a very good illustration of the costs which the federal government incurs by keeping the interest rate to the borrowers at 3 percent in the NDSL

and 7 percent in the GSL.* With reasonable assumptions regarding administrative costs and default and a discount rate of 8.5 percent applied to dollars in the future, he concluded that the net cost to the government of a new FCC of $100 was $54. A critical ingredient of this calculation is its reliance on the arrangement, already discussed, that roughly 90 percent of money repaid to the NDSL fund administered by a college still remains the property of the federal government. For the GSL, again with several reasonable assumptions including a discount rate of 8.5 percent and a special allowance of 2.5 percent, Johnstone concluded that the present value of all costs which the federal government incurred when it insured $100 of GSL lending was $41. Of this $41, roughly $31 was accounted for by the in-school interest subsidy and special allowance; only $8.19 was for defaults.

In the period since Johnstone provided these calculations, interest rates have become even higher. It is instructive to redo Johnstone's calculations bringing his rates up to date as of mid-1979. In particular, using a discount rate of 9 percent and a special allowance of 5 percent, the net present value of the cost of a new FCC of $100 becomes $55 which is not much of an increase, but the present value of the costs associated with $100 of GSL lending becomes $54 which is a substantial increase from $41. The major factor creating that large increase is the change in the special allowance. Changing its rate from 2.5 to 5 percent doubles the current dollars devoted to paying the special allowance in every year the loan is outstanding.

Method of Allocating Loans to Parents and Students

Under NELB there must be a procedure for allocating loans to individuals. Who is to be allowed to borrow, and what is to be the limit

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*D. Bruce Johnstone, "Federally Sponsored Student Loans: An Overview of Issues and Policy Alternatives," in Lois D. Rice, Editor, Student Loans: Problems and Policy Alternatives (New York: College Entrance Examination Board, 1977), pp. 34-40.

on the size of loans? Here is the proposal. When a student's bills are not simply being paid from internal resources, the family or the student will be self-designated in one of two ways: applying for a NELB loan only or applying for financial aid. The difference is that applicants for an NELB loan only need not go through the process of need analysis but may simply borrow up to 50 percent of the cost of education per family with the additional constraint that the student himself or herself may borrow no more than half of that limit. As the NELB's agent, the FAO may check a parent's credit history and refuse a loan to a parent when the record is sufficiently shaky. To those who are self-designated as applicants for financial aid and who qualify for it, a package of aid will be assembled in the usual way on the basis of need. Part of any package of financial aid will ordinarily be an NELB loan, although as mentioned earlier, there is an important sense in which the NELB loan itself is not financial aid.

Manageability of Repayment and Provision for Deferment and Forgiveness

A major matter requiring attention is that the size of loans not be so large that repayment becomes unmanageable. The loans are available to both students and their parents, and although the issue of manageability pertains to both, there is a special concern regarding the students who are younger and whose familiarity with credit may be especially limited.

Several points are pertinent concerning the burden of repayment for students. First, it is important to emphasize that, by comparison with NDSL and GSL, under the plan advanced no public agency pays the interest while the student is enrolled. Unless the student or the family pays the interest, it will simply accumulate. Table 13 illustrates the point. It indicates, under simple and specified assumptions, how much debt a student will have, as of graduation, if he or she borrows $1000 at the beginning

of the sophomore, the junior, and the senior years and allows the interest to accumulate. The assumed rate is 9 percent per year. In this case the principal borrowed is $3000, but by the day of graduation, the debt to be amortized is $3501. Because of the strong recommendation accompanying this plan for an NELB that loans to freshmen be made as sparingly as possible, the lending was assumed to go on for only three of the four undergraduate years. Had a $1000 loan been taken at the beginning of the freshman year as well, the debt, as of graduation, would have been $4884.

TABLE 13

Amount Owed at End of Each of Three
Upperclass Years on Each of Three $1000 Loans,
Each Taken at the Beginning of One of the Years,
Annual Interest at 9 Percent*,**

Year	Loan 1	Loan 2	Loan 3
1	1068		
2	1164	1164	
3	1269	1269	1164

Total borrowed = $3000
Total owed at graduation = $3501

*For purposes of computing interest, an academic year is assumed to be three-quarters as long as a calendar year.

**Interest is accumulated once per year on the principal and any previously accumulated interest.

This accumulation of interest during the time the student is in school suggests one obvious role for parents. The entire approach to financial aid, of which this plan for the NELB forms a part, is predicated on the assumption that parents should contribute as much as possible towards the costs of their children's undergraduate education. An additional goal,

however, is to provide maximum flexibility for the members of each family to decide for themselves how the burden of paying for education is to be shared between the older and younger generations. One specific option which the accumulation of interest suggests is that, when the student borrows, the parent would pay the interest during the in-school period, a function currently performed by the federal government explicitly in the GSL and implicitly in the NDSL. In that way, once the student enters repayment, he or she could begin to amortize the principle actually borrowed rather than the larger value of the principal plus accumulated interest.

Once the issue of amortization arises, the question is: over what period? The maximum period of repayment under GSL and NDSL is ten years. The proposal regarding the NELB is to permit -- though certainly not to require -- a longer period, 15 years for parents and 20 years for students. If, in the context of the general level of interest rates in mid-1979, the borrowers were required to pay the government's cost of capital, payment to amortize any given principal would increase. The longer repayment period is intended as at least partial compensation.

Table 14 makes explicit some of the possibilities regarding interest rates, periods of repayment, and larger sums to amortize because of the accumulation of interest. Consider one example. The monthly payments to amortize a $6000 loan over 10 years is $58 under NDSL, $70 under GSL, and $76 under the current proposal, assuming that 9 percent is the current cost of capital to the government. If the period of repayment were extended to 15 years, the monthly payment would be $61, and over 20 years it would be $54. Of course with accumulation of interest the actual borrowing leading to a sum of $6000 to amortize would be less than $6000. In particular, if

TABLE 14

Equal Monthly Payments,*
Various Size Loans, Interest Rates,
Periods of Repayment

Period of Repayment (Years)	Interest Rate (percent per year)	Principal (dollars)						
		1,000	3,000	6,000	12,000	15,000	20,000	25,000
5	3	18	54	107	214	268	357	447
	7	20	60	119	239	299	398	498
	9	21	62	125	249	311	415	519
	10.5	22	65	129	258	323	430	538
	12	22	67	134	267	334	445	556
10**	3	10	29	58	116	145	193	242
	7	12	35	70	140	176	234	293
	9	13	38	76	152	190	253	317
	10.5	14	41	81	162	203	270	338
	12	14	43	86	172	215	287	359
15	3	7	21	41	83	104	138	173
	7	9	27	54	108	135	180	225
	9	10	30	61	122	152	203	254
	10.5	11	33	66	133	166	221	277
	12	12	36	72	144	180	240	300
20	3	6	17	33	67	83	111	139
	7	8	23	47	94	117	156	192
	9	9	27	54	108	135	180	225
	10.5	10	30	60	120	150	200	250
	12	11	33	66	132	165	220	276
25	3	5	14	28	57	71	95	119
	7	7	21	43	85	107	142	178
	9	8	25	50	101	126	168	210
	10.5	9	28	57	113	142	189	236
	12	11	32	63	126	158	211	264

*to nearest dollar

**maximum term under NDSL and GSL

the borrowing were done in equal installments at the beginning of each of the last three years of college, the total principal borrowed would have been $5076. Alternatively, if a total of $6000 had been borrowed in the sequence just described -- $2000 at the beginning of each of the three years -- the amount to amortize would be $7093. The exact monthly payments for $7093 do not appear in the table, but one can calculate them to be, at 9 percent, $90, $72, and $64 for periods of amortization of 10, 15, and 20 years, respectively.

It is one thing to do the arithmetic linking a particular pattern of borrowing with the implied stream of repayments and quite another to estimate manageable loan limits for individuals or categories of individuals. Estimating what is manageable implies, among other things, some forecast about income in the future, and making such estimates is obviously a tricky undertaking.

Dwight H. Horch published an excellent paper on this topic in March, 1978 in which he systematically estimated the debt which those entering particular professions could regard as manageable.* His paper is thorough and detailed. He defines the manageable annual payment as one equivalent to the component which the BLS, in constructing its budget standards, refers to as "other consumption," roughly the discretionary residual. Based on that definition, he then links alternative annual incomes to maximum manageable loans under various assumptions about interest rates and schedules of repayment.

One of the paper's especially interesting features is its exploration of the Graduated Repayment Option (GRO) in which the annual payments are related to annual income rather than remaining constant as they do in, for

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*Dwight H. Horch, "Estimating Manageable Educational Loan Limits for Graduate and Professional Students," (Princeton, New Jersey: Educational Testing Service, March, 1978).

example, the typical mortgage on a home. Since one's income routinely rises, payments which are linked to income will ordinarily rise, too. Horch shows the power of the GRO to increase the manageable loan limit. A sample of his findings appears in Table 15. Those for whom debt is distasteful will not appreciate these results, but others, who are looking for ways to enable students in professional programs to assume a large proportion of the cost of their training, will find them well worth noting. The general finding is that, in most instances, the GRO more than doubles the amount of debt regarded as manageable. Anyone who has ever had a standard mortgage -- one with constant monthly payments -- for any length of time during a period of inflation should easily appreciate the point. As time passes, the constant payments become an ever smaller proportion of real income.

TABLE 15*

Horch's Estimates of the Impact of a Graduated Repayment Option (GRO) Upon Manageable Loan Limits, 15-Year Amortization, 7% Interest (thousands of dollars)

Group	Equal Repayments	GRO**	Assumed Year Repayments Begin	Assumed Income During First Year of Repayment
Males with 5 years or more of college	9.1	16.0-18.9	1983	22.6
Lawyers	8.2	25.7-31.4	1982	21.0
Physicians: Repayments Beginning After Residency	20.4	47.9-59.8	1987	47.6
Physicians: Repayments Beginning in Internship	9.7	25.0-30.7	1983	23.5
Doctoral Scientists and Engineers	12.0	17.5-20.6	1983	28.0

*Horch, "Estimating Manageable Educational Loan Limits for Graduate and Professional Students," p. 22.

**Lower limit assumes rate of inflation at 3 percent; upper limit assumes, 6 percent.

Beyond Horch's work pertaining to certain graduate and professional programs, much more needs to be learned about how much debt is "too much." The problem is more serious for students than for their parents because, for the most part, the parents' patterns of earning are established, and they should have a relatively accurate sense of the level of debt they can incur. For the student, things are much more speculative. A given volume of borrowing might be easily manageable if things work out in one way and quite an unpleasant burden if they don't. For now the best course is to leave these matters largely in the hands of the FAO with the understanding that he or she is to be especially mindful of the problems of repayment for student borrowers in both categories: those for whom the loan is a portion of a package of financial aid and those who, without being candidates for financial aid, borrow up to twenty-five percent of the cost of education without undergoing a means test.

Although I am not now in a position to be specific in estimating manageable loan limits for particular categories of undergraduates, there is still the question of establishing criteria for declaring, after the fact, that a mismatch exists between a loan in repayment and an income being earned, for declaring that the burden is excessive and that therefore the mechanism which allows for forgiveness should take effect.

It is important to specify that the proposed approach is not a program of income-contingency as that concept is ordinarily defined. Rather it is an approach to offer some ultimate protection against the distress of unmanageable debt. In the cases of death and disability, debts are simply to be cancelled. Apart from these catastrophies, however, people are not automatically excused from their debts as soon as their income drops below some particular level. Deferment of the obligation to a time when it is once

again manageable is an important feature of the program. Only in the end, after the full period originally scheduled for repayment has passed, is any remaining debt to be forgiven.

The cost of forgiveness, as well as of cancellation for death and disability, must somehow be borne, and the proposal here is that these costs be paid by the taxpayers generally rather than, as has sometimes been proposed, by those borrowers whose incomes are large enough so that deferment is not an issue.

Establishing standards under which repayment may be deferred is far from a thoroughly objective process, and moreover, there is an important question of policy at stake. The standard can be either harsh or lenient. How harsh or how lenient will influence the cost, but the harshest standard will not necessarily be the least costly. There is probably a point beyond which further efforts to suppress the cost of forgiveness will lead to some partially offsetting increase in default. Of course in an indirect way a very harsh standard for forgiveness will probably reduce costs by discouraging some who are especially debt-shy from borrowing in the first place.

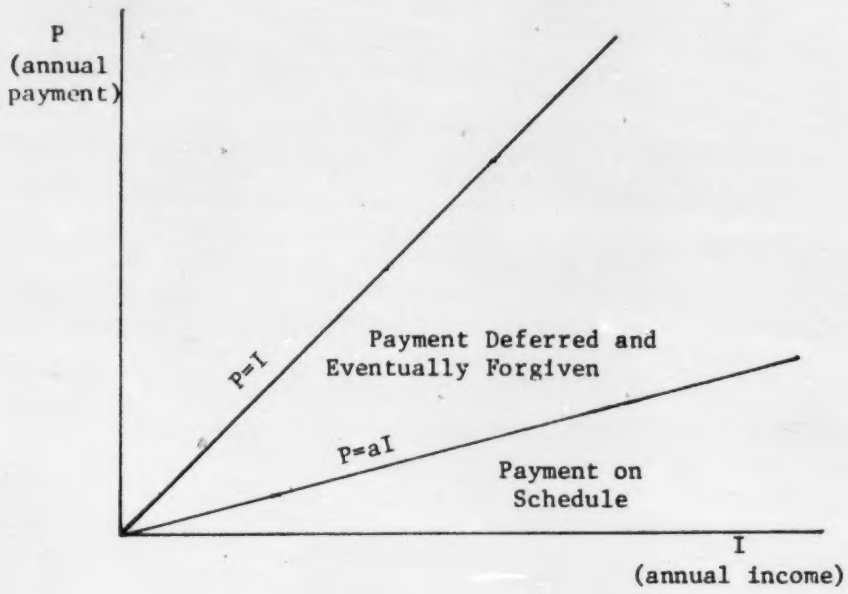
The general procedure envisioned to govern deferment and forgiveness is the following. A proportion of income -- somehow defined -- is specified as a limit in the following sense. If the scheduled repayment exceeds that percentage of income, the excess should be deferred, but amounts in deferment should not accumulate interest. In any later year for which the scheduled repayment is below the specified proportion of income, the amount in deferment should be paid until the obligation is completed or until the amount paid during that year equals the specified percentage of income. When the maximum allowable period of repayment has ended, any amount in deferment should be forgiven.

The central variable to determine is the specified portion of income which serves as a boundary between an acceptable and an excessive level of payment. Figure 1 illustrates the point. Annual income (I) is measured horizontally and annual payment (P) is measured vertically. The line labelled P=aI is the general form of the boundary separating combinations of income and payment for which deferment is permitted -- those above the line -- from those for which it is not -- those below the line. The proportion of income regarded as the upper limit for an annual repayment is designated by the letter "a." Figure 2 allows "a" to take on two specific alternative values, .04 and .2. The former provides a relatively lenient standard, the latter a relatively strict one.

Tables 16 and 17 provide some illustrative empirical content for these general concepts. Each table contains data on the maximum loan that will just fail to qualify for forgiveness under a variety of different conditions concerning the type of loan, the income of the borrower, and the criterion used to define when the situation entitles the borrower to a deferment. The general criterion is that a borrower is entitled to a deferment when the payment exceeds x percent of "income" defined as Adjusted Gross Income (AGI) reduced by federal income taxes and the FICA contribution. The four percentages used are 4, 8, 12, and 16. Three different kinds of loans are assumed. Both the NDSL and the GSL carry the maximum repayment period of 10 years. The NELB loan is at 9 percent and for 20 years, the maximum period of repayment intended when the student borrows. The three loan limits corresponding to a particular income and forgiveness criterion -- for example, $1500, $1250, and $1396 in Table 16 corresponding to an AGI of $5000 and the four percent criterion -- have a common annual or monthly payment; that is the basis on which they are united. Tables 16 and 17 differ in that the

FIGURE 1*

General Illustration of Regions Where There is and is Not Deferment and Eventual Forgiveness



*The horizontal and vertical axes are not conceived as being on the same scale. The same is true for Figures 2 and 3.

FIGURE 2

Illustration of Regions Where There is and is Not Deferment and Eventual Forgiveness, a=.04 and .2

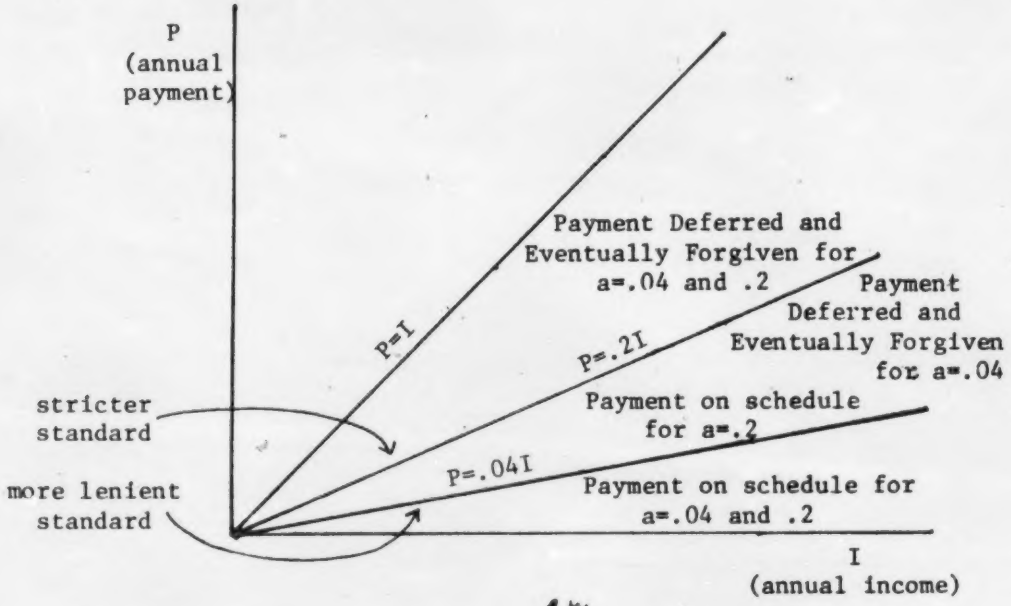


TABLE 16

Largest Loan Not Qualifying for Forgiveness,
By Level of Income, Type of Loan, and
Forgiveness Criterion, for a
Single Individual Filing IRS' Calendar Year 1978 Form 1040A

(The forgiveness criterion is: payment greater than X% of AGI minus federal income tax and FICA.)

Adjusted Gross Income (AGI)	X% = 4% Loan Limit			X% = 8% Loan Limit		
	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.
$ 5,000	$ 1,500	$ 1,250	$ 1,396	$ 3,050	$ 2,050	$ 2,792
10,000	2,850	2,350	2,580	5,700	4,700	5,161
15,000	4,050	3,350	3,722	8,150	6,700	7,403
20,000	5,250	4,350	4,780	10,500	8,650	9,560
25,000	6,350	5,250	5,753	12,650	10,500	11,548
30,000	7,450	6,150	6,810	14,900	12,350	13,578
35,000	8,450	7,000	7,699	16,900	14,000	15,397
40,000	9,400	7,750	8,545	18,800	15,550	17,137

Adjusted Gross Income (AGI)	X% = 12% Loan Limit			X% = 16% Loan Limit		
	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.
$ 5,000	$ 4,550	$ 3,750	$ 3,765	$ 6,100	$ 5,050	$ 5,541
10,000	8,500	7,050	7,783	11,470	9,470	10,448
15,000	12,200	10,100	11,125	16,250	13,450	14,805
20,000	15,700	13,000	14,340	20,950	17,350	19,120
25,000	19,000	15,700	17,343	25,300	20,950	23,096
30,000	22,350	18,500	20,389	29,850	24,700	27,199
35,000	25,350	21,000	23,138	33,850	28,000	30,879
40,000	28,200	23,300	25,676	37,600	31,100	34,263

TABLE 17

Largest Loan Not Qualifying for Forgiveness,
By Level of Income, Type of Loan, and
Forgiveness Criterion, for a
Family of Four Filing Jointly IRS' Calendar Year 1978 Form 1040A

(The forgiveness criterion is: payment greater than X% of AGI minus federal income tax and FICA.)

Adjusted Gross Income (AGI)	X% = 4% Loan Limit			X% = 8% Loan Limit		
	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.
$ 5,000	$ 1,600	$ 1,350	$ 1,481	$ 3,250	$ 2,650	$ 2,961
10,000	3,100	2,550	2,792	6,150	5,100	5,626
15,000	4,350	3,600	3,976	8,750	7,250	7,952
20,000	5,650	4,600	5,161	11,150	9,350	10,279
25,000	6,850	5,700	6,260	13,750	11,350	12,521
30,000	8,100	6,700	7,360	16,150	13,400	14,763
35,000	9,200	7,600	8,375	18,350	15,200	16,751
40,000	10,200	8,450	9,306	20,400	16,900	18,612

Adjusted Gross Income (AGI)	X% = 12% Loan Limit			X% = 16% Loan Limit		
	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.	NDSL 3%/10yr.	GSL 7%/10yr.	NELB 9%/20yr.
$ 5,000	$ 4,850	$ 4,000	$ 4,399	$ 6,450	$ 5,350	$ 5,880
10,000	9,250	7,650	8,418	12,300	10,200	11,210
15,000	13,100	10,850	11,929	17,450	14,450	15,947
20,000	16,900	14,000	15,397	22,550	18,650	20,558
25,000	20,600	17,050	18,781	27,500	22,700	25,042
30,000	24,250	20,050	22,123	32,350	26,750	29,483
35,000	27,550	22,800	25,084	36,700	30,400	33,459
40,000	30,600	25,350	27,918	40,800	33,800	37,224

former pertains to a single individual and the latter to a family of four filing one federal income tax return. In both cases, it is IRS' short form -- 1040A -- which is filed.

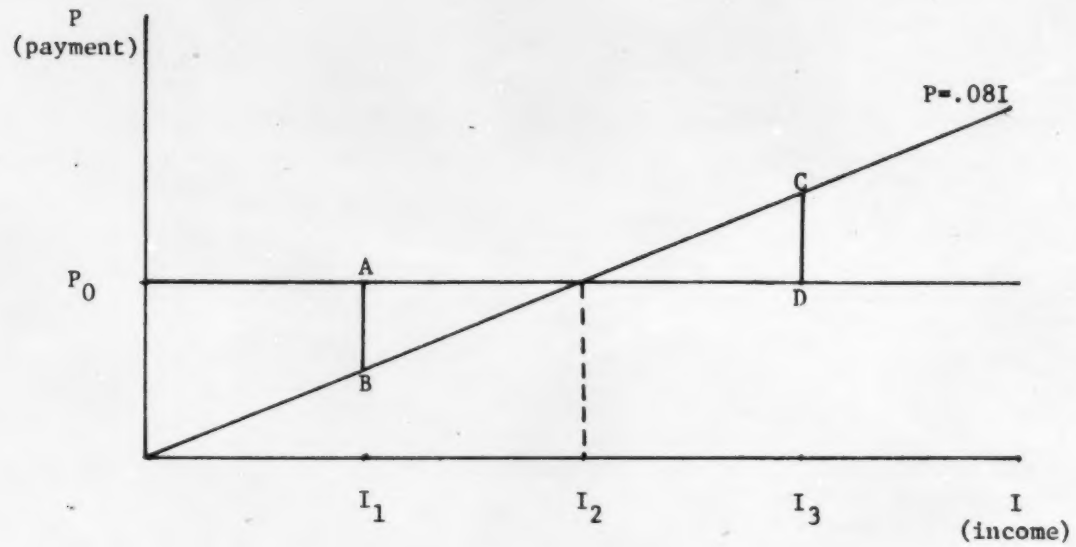
Studying these two tables helps to clarify some important relationships. One particularly interesting issue is the connection between these tables and the GRO. The tables suggest that if there is no stigma in accepting a deferment, one might very well decide to turn the scheme proposed here into a GRO of his or her own by borrowing "too much" based on the anticipated level of income in the early years with the expectation that later on there will be "more than enough" to pay any amounts deferred. In this scenario the forgiveness feature which is based on efforts to alleviate hardship has, within it, at least the potential to spawn a GRO somewhat spontaneously.

The point is illustrated very simply in Figure 3 where P=.08I has the usual interpretation and where P_0 is the annual payment on a loan which just fails to qualify for forgiveness under an assumed 8 percent criterion when income equals I_2. The point is that had the borrower been inclined to borrow "too much" when his income was I_1 so that the "proper" payment fell short of P_0 by AB, he would have "more than enough" to pay the amount deferred when his income finally reaches I_3 because in that situation, P_0 is less than the amount the system assumes he can afford by CD.

Tables 16 and 17 also serve to clarify that the size of the forgiveness criterion is, in some sense, double-edged. A relatively low criterion, say, 4 percent has been described as lenient and a relatively high one, say, 20 percent, as harsh, and there is an important sense in which these descriptions are accurate, but there is also more to it. A so-called "lenient" criterion could simply invite a fairly severe restriction of credit to keep the cost

FIGURE 3

Possibility for a Self-Created GRO
to Permit Borrowing "Too Much"



of forgiveness from becoming excessive. By contrast, a so-called "harsh" criterion could lead to a loosening of credit. Admittedly such a loosening, if carried too far, could have unpleasant consequences if young people, unfamiliar with credit, got in over their heads. On the other hand, the increased availability could enable some to aspire to educational opportunities that might otherwise simply be beyond their reach. The general point is that the forgiveness criterion cannot be viewed and assessed in isolation, and its impact upon the availability of credit is an especially important related factor.

Before ending this discussion of forgiveness, one special variant of the low income problem should be mentioned: that pertaining to non-working spouses with educational debts. Now is not the time to settle this issue fully, but it is important to identify it as one needing eventually be to resolved. The general outline of a solution is that the loans should be amortized subject to some limit on the size of the monthly payment and a provision for deferment. If both husband and wife have loans, the limit to be reached before deferment becomes an option should be larger than if only one has a debt. Moreover, it is important that the record be perfectly explicit about which loan each payment is amortizing and, if there is deferment, how much is being deferred on each loan so that, should there ever be a divorce, the possibility of a misunderstanding about the size of each person's remaining debt is minimized.

Macrocosmic Considerations: Volume of Lending and Cost

So much for the microcosmic considerations. What about the aggregate volume of lending and the cost of what is being proposed in this paper in comparison with the existing federal program and the direction it is likely to take?

Is the aggregate volume of lending a matter of concern for public policy? Obviously in some very general way it is, but it is of much greater concern if, as at present, the government pays a large proportion of the associated cost or very close to it. Those elements of cost which the government incurs and which vary approximately in proportion with the volume of lending are now relatively large but would be relatively small under the proposal, especially small if the plan to control defaults works as intended. Thus, under the current arrangements a major change in the scale of lending -- say, a doubling -- would be expected to produce a very large absolute increase in the government's cost whereas under the proposal, it would not. For this reason, the aggregate size of the program is a matter of much less practical consequence to the government under the proposal than it is at present.

More or less, the government's concern about the aggregate volume of lending should vary with the amount by which its cost of capital exceeds the rate of interest the borrowers actually pay. The proposal is to have the difference be zero as a matter of policy, but there are acceptable alternatives which others might find preferable. One would be to charge borrowers a rate slightly below the government's cost as a way to encourage the purchase of higher education by means of a small subsidy. Alternatively, the rate might exceed the government's cost if it were judged desirable to pass along to the borrowers the costs of death and disability, administration, and/or default, and/or forgiveness for those with income so low that the original schedule of repayments must be altered.

In estimating what the volume of lending would be under NELB, several considerations are pertinent. For one thing, there is reason to believe that some parents are now borrowing fairly substantially for higher education, outside the federal programs. If offered the opportunity to borrow at the government's cost of capital, many of these parents would probably

accept. When they did, there would be an increase in borrowing in one section of the market, but a decrease elsewhere. Parents' demand for NELB loans would not be a full net increase in demand.

The availability of NELB loans may increase the demand for private education among those for whom coming up with the cash has been a severe constraint in the past. On the other hand, the possibility of borrowing for higher education may prompt people to do their own private cost-benefit analysis more conscientiously than they have before, and not everyone may conclude that the opportunity is a good one. Some, who might routinely have attended college in an era of relatively open access to the more distinguished public institutions, may have second thoughts when faced with the prospect of borrowing fairly substantial sums to attend such institutions.

All things considered, NELB may not raise the volume of educational lending more than $1.3 billion above what it would be if the current course were played out. Here is why. Just now the volume of government sponsored lending is about $2.7 billion. There is perhaps another $250 million of private lending. MISAA should have a major impact on the demand for GSL loans, raising it perhaps by $750 million. That demand would be more certain to be converted to actual loans if Congress raises the special allowance to keep the private lenders from severely rationing funds. Thus, when things stabilize, educational lending could be at an annual rate of $3.7 million, even without NELB.

A very crude estimate, balancing a variety of pluses and minuses, is that under NELB, borrowing for undergraduate education will not exceed $5 billion annually. If it were actually at that level it would exceed the current volume of government sponsored lending by about $2.3 billion, but -- on the assumption that parents are already borrowing privately about $250

million -- it would exceed all undergraduate educational lending currently estimated to exist by perhaps only $2.0 billion, and it would exceed the level to which MISAA is likely to raise total lending maybe by $1.3 billion and maybe by less.

What will NELB cost? There is a simple and a more sophisticated answer to that question. The simple answer focuses on the operating costs which include the costs of administration, cancellation for death, disability, default, and forgiveness.

As the program is being proposed, no costs for forgiveness can literally be incurred on the bank's accounts until fifteen years after a loan is initiated in the case of a loan to a parent and twenty years after repayment is initiated in the case of a loan to a student, but in less than either of those periods, deferments can certainly reduce the flow of cash coming to the bank in the form of repayments.

The importance of organizing collection well has been emphasized. The proposal is to use the IRS. If it would be regarded as additionally helpful to use the Social Security Administration, that agency should also be called on for assistance. The assumption is that if the process of collection is taken seriously and run well, default will become a fairly minor issue. Currently the capital value of the loans entering default in a given year in GSL and NDSL is perhaps $300 million. What seems like a conservative assumption is that, even with NELB's larger volume of lending, it can be reduced to $100 million, and it should be possible to do much better still.

Cancellation for death and disability as well as administration might cost $50 million. Death and disability will, no doubt, be somewhat higher under NELB than under GSL and NDSL because the population of borrowers will include the parents of students and will therefore have a higher average age, but the parents of college students are still, on average, moderately young in this

context, and therefore the cost to the program from death and disability should remain relatively small.

All told, with a reasonable balance established between the forgiveness criterion and the size of individual loans, these various items -- cancellation for death and disability, default, forgiveness, and administration -- might cost in the neighborhood of $250 million.

The more sophisticated answer regarding what NELB will cost concerns the cost associated with obtaining funds to lend. If it is to lend $5 billion a year, it must obtain these funds. A simple way of obtaining them is for Congress to appropriate the money. However, the way proposed is for the NELB to have access to the FFB and to borrow, via that mechanism, at the same rate the government must pay to issue obligations of comparable maturity.

An approach to understanding the cost the government incurs in providing the NELB with capital to lend is to focus on the cash flows in a somewhat simplified case. Here is the scenario. Let the underlying demand for educational loans be $5 billion per year. On this basis the federal government borrows $5 billion from the public in the first year, and pays annual interest at 10 percent on the outstanding principal. The government makes this money available to the NELB which lends it, half to students and half to parents, at an annual rate of interest of 9 percent. The parents begin repayment immediately, and the students, in the fifth year. The government repeats this process year after year. Each year, each dollar of repayment to the NELB is earmarked as a dollar of interest or a dollar of principal. The principal is devoted to retiring the outstanding debt, as it matures, and the interest is devoted to paying interest to the holders of the government's obligations. To the extent that the interest earned from those repaying loans to NELB is insufficient to pay fully the interest owed on the

government's outstanding obligations, the difference is assumed to be paid out of the federal government's general tax revenues.

The questions to pursue are these. First, since the government continues to borrow from the public, does the value of its outstanding obligations keep growing without end, or does it reach a limit? Second, if an equilibrium does exist, how long does it take to reach it? Third, since the government -- of which the NELB is regarded as a part -- pays interest to those from whom it borrows and receives interest from those parents and students to whom it lends, what is the net cost for interest on these two partially offsetting transactions? What, in short, is the annual cost which the government must incur to provide a flow of capital of $5 billion a year to help finance education?

The data in Table 18 provide answers to these three questions as well as some insight into the general dynamics of the financing of the NELB. The purpose of the table is to follow the value of the relevant variables from the beginning of the program until the time when it may be regarded as having achieved equilibrium. In equilibrium the value of each variable will remain constant from year to year.

Table 18 shows that, under the conditions specified, the flow of funds stimulated by the original -- and annually unchanging -- demand to borrow $5 billion may be regarded as reaching equilibrium in the twenty-fourth year. In that year the outstanding debt of the federal government on this account is $62.5 billion, and thereafter it will effectively not change. Why not? Because the government's annual borrowing of $5 billion is balanced -- all but absolutely exactly -- by the repayment of $4.99 billion of principal, shown in column (8), which is, in turn, devoted to retiring $4.99 billion of the government's outstanding debt.

In the twenty-fourth year, the net interest cost to the government of its borrowing from the public and lending to parents and students is $1.28

TABLE 18*

NELB: Simplified Analysis of the Path to the Steady State**
(billions of dollars)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Year	U.S. Gov't. Borrowing from Public	Value of U.S. Government Obligations Outstanding	U.S. Govt.'s Interest Expense [10% of (3)]	NELB Loans to Parents and Students	Repayment to NELB on all Outstanding Educational Loans			Net Interest Cost to the U.S. Gov't. (4) - (7)
					Total	Interest	Principal	
1	5	4.9	.49	5	.30	.22	.08	.27
2	5	9.7	.97	5	.61	.44	.17	.54
3	5	14.5	1.45	5	.91	.64	.27	.80
4	5	19.1	1.91	5	1.22	.84	.38	1.07
5	5	23.6	2.36	5	1.78	1.25	.53	1.11
6	5	27.9	2.79	5	2.37	1.65	.72	1.14
7	5	31.9	3.19	5	2.94	2.02	.92	1.17
8	5	35.8	3.58	5	3.49	2.36	1.14	1.22
9	5	39.4	3.94	5	4.09	2.72	1.37	1.22
10	5	42.8	4.28	5	4.67	3.04	1.63	1.24
11	5	45.9	4.59	5	5.24	3.33	1.91	1.26
12	5	48.7	4.87	5	5.82	3.60	2.22	1.27
13	5	51.1	5.11	5	6.39	3.83	2.56	1.28
14	5	53.2	5.32	5	6.96	4.04	2.93	1.28
15	5	54.8	5.48	5	7.54	4.21	3.33	1.28
16	5	56.4	5.64	5	7.81	4.35	3.46	1.29
17	5	57.8	5.78	5	8.08	4.49	3.59	1.29
18	5	59.1	5.91	5	8.34	4.61	3.74	1.30
19	5	60.1	6.01	5	8.62	4.71	3.91	1.30
20	5	61.1	6.11	5	8.89	4.80	4.09	1.30
21	5	61.8	6.18	5	9.16	4.87	4.29	1.30
22	5	62.3	6.28	5	9.42	4.92	4.50	1.31
23	5	62.5	6.25	5	9.70	4.96	4.74	1.29
24	5	62.5	6.25	5	9.97	4.98	4.99	1.28
25	5	62.5	6.25	5	9.97	4.98	4.99	1.28

*Details may not add precisely to totals due to rounding.
**See text for explanation.

billion, the difference (off by a fraction because of rounding) between the $4.98 billion of interest which it receives and the $6.25 billion which it pays. A comprehensive estimate of the cost of the program, therefore, is about $1.5 billion, the net interest cost plus the estimated $250 million cost of default, death, disability, forgiveness, and administration.

There are a number of comments to make about this result. First, it relates to a relatively simplified scenario from which such complexities as inflation, changing rates of participation in higher education, altered schedules of expected parental contributions, to name but a few, are omitted.

Second, how does this cost of $1.5 billion compare with the current cost of GSL and NDSL, both in the aggregate and per dollar loaned? On an annual basis, the current programs generate about $2.7 billion of lending and cost about $1.3 billion. The estimate is that for the $1.5 billion of cost, NELB would generate $5 billion of lending. What this means is that the cost of the program per dollar loaned is expected to drop from $.48 now to $.30 under NELB, a decline of 37.5 percent.

Third, under the assumed conditions, the volume of federal debt will, in equilibrium, be greater by $62.5 billion than it would otherwise have been. Is this a cause for worry? This is not the place to restate the case for and against deficit financing. What can be said is that by allowing the debt to increase by $62.5 billion -- and that full increase does not come until twenty-four years in the future -- the government can enable parents and students to borrow $5 billion for a cost of $1.5 billion.

Is this option attractive? That is a hard question to answer, and the associated question must really be: compared to what? For example, to provide $5 billion of purchasing power for higher education in the form of grants would cost $5 billion. By comparison with that option the loans are much more economical.

There does remain the issue of whether the increase of $62.5 billion in the size of the debt will drive up the cost of borrowing generally and, in that sense, leave some, who would have been borrowers under the status quo ante, with less credit, a phenomenon referred to as "crowding out." Regarding this issue there are two points to make: first, in the context of the government's overall level of borrowing, it seems highly unlikely that the borrowing to accommodate the NELB will have much impact upon the general tone of the credit market one way or the other. The volume of activity just is not sufficiently large, and the relevant supply function is probably not sufficiently inelastic. Second, in the calculations that underlie Table 18, the government's cost of borrowing was assumed to be one point above the interest rate charged to NELB's borrowers, 10 percent as opposed to 9 percent. It is far-fetched to attribute to the annual borrowing of $5 billion to finance NELB an increase of one percent in the overall cost of long-term credit in the American economy. However, those for whom both "crowding out" and the cost of this program are matters of special concern may be reassured in knowing that the $1.5 billion cost of providing the capital was generated on this cautious assumption. For this reason it is probably, if anything, a bit of an overestimate, other things being equal. To pursue the point, it is interesting to note that if one were to assume a 9 percent cost of borrowing for the government, the program would become far less expensive. In that case the net interest cost to the U.S. government would peak at $880 million in the fourth year and thereafter would decline to its steady-state level of $650 million in the twenty-fourth year. At that point, still assuming other costs of $250 million, the total cost of the program would be only $900 million.

With reference to NELB's cost, a point not to be overlooked is the possible availability of the NDSL stream of repayments as an asset for the new bank. If NDSL were terminated, that stream would continue for a number of years at approximately $300 million per year. With that asset, NELB's net annual cost would be reduced during those years in which the stream continued. For many of those years the reduction could be as much as $300 million. In the later years, the amount would be smaller as the size of the stream gradually dwindled.

A final consideration is the possibility that, even if it establishes NELB, Congress might want to provide some effective limit on the volume of lending. In that case loans would have to be rationed. A section of this overall proposal for the NELB addressing that issue has not yet been developed. If rationing per se must emerge, some procedure will be needed to determine each institution's share of the available funds. However, experience with allocating the campus-based funds serves as a reminder that such procedures tend to be cumbersome. Therefore, if it is at all possible, the cost of capital to the borrower should be the main factor rationing the demand for loans.

IV. CONCLUDING OBSERVATIONS

This paper has presented the general outline of an educational loan bank, NELB, which is proposed as an alternative to the current programs of educational lending sponsored by the government, NDSL and GSL. The omission of the word "student" from the bank's title should serve as a reminder that, although this bank certainly lends to students, it lends to parents as well. Indeed the bank's provision of loans to parents is one of its central features.

The NELB makes essentially unsubsidized loans and, for that reason, may give the appearance of being more callous than the NDSL and the GSL, but to draw such a conclusion would be both superficial and wrong. To begin with, the intention is that those borrowing for education have access to the lowest possible interest rate consistent with covering or approximately covering the cost of providing the capital. Moreover, the interest rate itself is not the major determinant of how much must be borrowed. That quantity depends upon how much is available from the other sources of support before lending -- which is the residual -- must be called upon.

When a loan is subsidized, it means that both a loan and a grant are being intermingled. A central principle of the NELB is that the haphazard mixture of grant and loan in the current loan programs should be disentangled. Once grants and loans are separated it will be possible to know the amount of each actually being provided, and such information should facilitate a rational discussion of the proper amount to spend on grants.

The proposal to establish NELB will surely face substantial opposition. To begin with, in the effort to provide borrowers the lowest possible unsubsidized level of interest, the plan is to by-pass the commercial banks in the educational lending process. Some banks may welcome the opportunity

to retreat from the headaches of lending to students, but others may not so lightly abandon this source of profit, potential or realized. Second, to create the NELB would be more or less to eliminate Sallie Mae's raison d'être, at least in its current form. Conceivably Sallie Mae could be the foundation upon which NELB might be built, but if so, its profit-making status would have to be altered. Third, the state guarantee agencies may find NELB threatening to their modus operandi which, to some extent, it almost surely would be. Possibly those agencies could join NELB as local offices closer to the institutions and students than the bank's central headquarters, but so far that possibility is not a well-developed idea. What NELB implies for the state agencies is a subject needing careful and extensive study. Finally, the advocates of low tuition can be expected to oppose an institution like NELB, seeing it as the opening wedge of a movement to pass much more of the costs of education along to students and their families. It is important to assure those advocates that nothing like that need necessarily result from the creation of NELB, but there is reason to think that they will not find such assurance comforting, persuasive, or satisfactory.

As a follow-up to mentioning the concern of those who support low tuition and as a note on which to end this paper, it is important to underline that the NELB is intended to serve the best interests of students in the realistic setting in which some portion of their educational expenses will all but certainly continue to be financed by borrowing. A mechanism for lending is in place. There is every reason to believe that it can be improved. It is to further that end that this proposal for the NELB is brought forward.